

ALTRIA GROUP, INC.

Form 10-K

February 26, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 1-08940

ALTRIA GROUP, INC.

(Exact name of registrant as specified in its charter)

Virginia 13-3260245
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

6601 West Broad Street, Richmond, Virginia 23230
(Address of principal executive offices) (Zip Code)
804-274-2200

(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|------------------------------------|---|
| Common Stock, \$0.33 1/3 par value | New York Stock Exchange |
| 1.000% Notes due 2023 | New York Stock Exchange |
| 1.700% Notes due 2025 | New York Stock Exchange |
| 2.200% Notes due 2027 | New York Stock Exchange |
| 3.125% Notes due 2031 | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
 Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files) Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if smaller reporting company) Smaller operating company

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Emerging growth company "

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). "Yes No

As of June 30, 2018, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately \$107 billion based on the closing sale price of the common stock as reported on the New York Stock Exchange.

Class

Outstanding at February 12, 2019

Common Stock, \$0.33 ¹/₃ par value 1,874,430,847 shares

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for use in connection with its annual meeting of shareholders to be held on May 16, 2019, to be filed with the Securities and Exchange Commission on or about April 4, 2019, are incorporated by reference into Part III hereof.

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Part I

Item 1. Business.

General Development of Business

General: Altria Group, Inc. (“Altria”) is a holding company incorporated in the Commonwealth of Virginia in 1985. At December 31, 2018, Altria’s wholly-owned subsidiaries included Philip Morris USA Inc. (“PM USA”), which is engaged in the manufacture and sale of cigarettes in the United States; John Middleton Co. (“Middleton”), which is engaged in the manufacture and sale of machine-made large cigars and pipe tobacco and is a wholly-owned subsidiary of PM USA; Sherman Group Holdings, LLC and its subsidiaries (“Nat Sherman”), which are engaged in the manufacture and sale of super premium cigarettes and the sale of premium cigars; and UST LLC (“UST”), which through its wholly-owned subsidiaries, including U.S. Smokeless Tobacco Company LLC (“USSTC”) and Ste. Michelle Wine Estates Ltd. (“Ste. Michelle”), is engaged in the manufacture and sale of smokeless tobacco products and wine. Altria’s other operating companies included Philip Morris Capital Corporation (“PMCC”), which maintains a portfolio of finance assets, substantially all of which are leveraged leases, and Nu Mark LLC (“Nu Mark”), both of which are wholly-owned subsidiaries. In December 2018, Altria announced the decision to refocus its innovative product efforts, which included Nu Mark’s discontinuation of production and distribution of all e-vapor products. Prior to that time, Nu Mark was engaged in the manufacture and sale of innovative tobacco products. Other Altria wholly-owned subsidiaries included Altria Group Distribution Company, which provides sales and distribution services to certain Altria operating subsidiaries, and Altria Client Services LLC (“ALCS”), which provides various support services in areas such as legal, regulatory, consumer engagement, finance, human resources and external affairs to Altria and its subsidiaries.

Altria’s reportable segments are smokeable products, smokeless products and wine. The financial services and the innovative tobacco products businesses are included in an all other category due to the continued reduction of the lease portfolio of PMCC and the relative financial contribution of Altria’s innovative tobacco products businesses to Altria’s consolidated results. For further information, see Note 16. Segment Reporting to the consolidated financial statements in Item 8. Financial Statements and Supplementary Data of this Annual Report on Form 10-K (“Item 8”). At September 30, 2016, Altria had an approximate 27% ownership of SABMiller plc (“SABMiller”), which Altria accounted for under the equity method of accounting. In October 2016, Anheuser-Busch InBev SA/NV (“Legacy AB InBev”) completed its business combination with SABMiller, and Altria received cash and shares representing a 9.6% ownership in the combined company (the “AB InBev Transaction”). The newly formed Belgian company, which retained the name Anheuser-Busch InBev SA/NV (“AB InBev”), became the holding company for the combined businesses. Subsequently, Altria purchased approximately 12 million ordinary shares of AB InBev, increasing Altria’s ownership to approximately 10.2% at

December 31, 2016. At December 31, 2018, Altria had an approximate 10.1% ownership of AB InBev, which Altria accounts for under the equity method of accounting using a one-quarter lag. As a result of the one-quarter lag and the timing of the completion of the AB InBev Transaction, no earnings from Altria’s equity investment in AB InBev were recorded for the year ended December 31, 2016. For further discussion, see Note 7. Investment in AB InBev/SABMiller to the consolidated financial statements in Item 8 (“Note 7”).

In January 2017, Altria acquired Nat Sherman, which joined PM USA and Middleton as part of Altria’s smokeable products segment.

On December 20, 2018, Altria purchased, through a wholly-owned subsidiary, shares of non-voting convertible common stock of JUUL Labs, Inc. (“JUUL”), representing a 35% economic interest for \$12.8 billion. JUUL is engaged in the manufacture and sale of e-vapor products globally. If and when antitrust clearance is obtained, Altria’s non-voting shares will automatically convert to voting shares (“Share Conversion”). At December 31, 2018, Altria accounted for its investment in JUUL as an investment in an equity security. Upon Share Conversion, Altria expects to account for its investment in JUUL under the equity method of accounting. For further discussion, see Note 8.

Investment in JUUL to the consolidated financial statements in Item 8 (“Note 8”).

On December 7, 2018, Altria announced that it entered into an agreement to purchase, through a subsidiary, approximately 146.2 million newly issued common shares of Cronos Group Inc. (“Cronos”), a global cannabinoid

company headquartered in Toronto, Canada. Cronos shareholders approved the transaction on February 21, 2019. The closing of this transaction remains subject to certain customary closing conditions, including receipt of required regulatory approval. Altria expects the transaction to close in the first half of 2019. Upon completion of this transaction, Altria will own an approximate 45% equity interest in Cronos. Additionally, the agreement includes a warrant to purchase up to an additional approximately 72.2 million common shares of Cronos at a per share exercise price of Canadian dollar (“CAD”) \$19.00. The purchase price for the approximate 45% equity interest and warrant is approximately CAD \$2.4 billion (approximately U.S. dollar (“USD”) \$1.8 billion, based on the CAD to USD exchange rate on February 22, 2019), to be paid on the date of the closing of the transaction. Upon full exercise of the warrant, which expires four years after issuance, Altria would own approximately 55% of the outstanding common shares of Cronos. The exercise price for the warrant is approximately CAD \$1.4 billion (approximately USD \$1.0 billion, based on the CAD to USD exchange rate on February 22, 2019). As part of the agreement, upon completion of this transaction, Altria will have the right to nominate four directors, including one independent director, to serve on Cronos’ Board of Directors, which will be expanded from five to seven directors. Altria expects to account for its investment in Cronos under the equity method of accounting.

In January and February 2019, Altria entered into derivative financial instruments in the form of forward contracts, which mature on April 15, 2019, to hedge Altria’s exposure to foreign

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currency exchange rate movements in the CAD to USD, in relation to the CAD \$2.4 billion purchase price for the Cronos transaction. The aggregate notional amounts of the forward contracts were approximately USD \$1.8 billion (CAD \$2.4 billion). The forward contracts do not qualify for hedge accounting; therefore, changes in the fair values of the forward contracts will be recorded as gains or losses in Altria's consolidated statements of earnings in the periods in which the changes occur.

Source of Funds: Because Altria is a holding company, its access to the operating cash flows of its wholly-owned subsidiaries consists of cash received from the payment of dividends and distributions, and the payment of interest on intercompany loans by its subsidiaries. In addition, Altria receives cash dividends on its interest in AB InBev and will continue to do so as long as AB InBev pays dividends. Altria expects to receive cash dividends from JUUL, if and when JUUL pays such dividends.

Narrative Description of Business

Portions of the information called for by this Item are included in Operating Results by Business Segment in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this Annual Report on Form 10-K ("Item 7").

Tobacco Space

Altria's tobacco operating companies include PM USA, USSTC and other subsidiaries of UST, Middleton and Nat Sherman. Altria Group Distribution Company provides sales and distribution services to Altria's tobacco operating companies.

The products of Altria's tobacco subsidiaries include smokeable tobacco products, consisting of combustible cigarettes manufactured and sold by PM USA and Nat Sherman, machine-made large cigars and pipe tobacco manufactured and sold by Middleton and premium cigars sold by Nat Sherman; smokeless tobacco products, consisting of moist smokeless tobacco ("MST") and snus products manufactured and sold by USSTC; and innovative tobacco products, including e-vapor products previously manufactured and sold by Nu Mark.

Cigarettes: PM USA is the largest cigarette company in the United States. Marlboro, the principal cigarette brand of PM USA, has been the largest-selling cigarette brand in the United States for over 40 years. Nat Sherman sells substantially all of its super premium cigarettes in the United States. Total smokeable products segment's cigarettes shipment volume in the United States was 109.8 billion units in 2018, a decrease of 5.8% from 2017.

Cigars: Middleton is engaged in the manufacture and sale of machine-made large cigars and pipe tobacco. Middleton contracts with a third-party importer to supply a majority of its cigars and sells substantially all of its cigars to customers in the United States. Black & Mild is the principal cigar brand of Middleton. Nat Sherman sources all of its cigars from third-party suppliers and sells substantially all of its cigars to customers in the United States. Total smokeable products segment's cigars shipment volume was approximately 1.6 billion units in 2018, an increase of 3.8% from 2017.

Smokeless tobacco products: USSTC is the leading producer and marketer of MST products. The smokeless products segment includes the premium brands, Copenhagen and Skoal, and value brands, Red Seal and Husky. Substantially all of the smokeless tobacco products are manufactured and sold to customers in the United States. Total smokeless products segment's shipment volume was 832.6 million units in 2018, a decrease of 1.0% from 2017.

Innovative tobacco products: In December 2018, Altria announced the decision to refocus its innovative product efforts, which includes Nu Mark's discontinuation of production and distribution of all e-vapor products. Prior to that time, Nu Mark participated in the e-vapor category and developed and commercialized other innovative tobacco products. In 2013, Nu Mark introduced MarkTen e-vapor products. In April 2014, Nu Mark acquired the e-vapor business of Green Smoke, Inc. and its affiliates, which began selling e-vapor products in 2009. In 2018 and 2017, Altria's subsidiaries purchased certain intellectual property related to innovative tobacco products. In December 2013, Altria's subsidiaries entered into a series of agreements with Philip Morris International Inc. ("PMI"), including an agreement that grants Altria an exclusive right to commercialize certain of PMI's heated tobacco products in the United States, subject to the United States Food and Drug Administration's ("FDA") authorization. PMI submitted a pre-market tobacco product application and a modified risk tobacco product application for its electronically heated tobacco product, IQOS, with the FDA's Center for Tobacco Products in the first quarter of 2017 and the fourth quarter

of 2016, respectively. Upon regulatory authorization by the FDA and subject to certain performance obligations, Altria's subsidiaries will have an exclusive license to commercialize IQOS in the United States.

Distribution, Competition and Raw Materials: Altria's tobacco subsidiaries sell their tobacco products principally to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services. The market for tobacco products is highly competitive, characterized by brand recognition and loyalty, with product quality, taste, price, product innovation, marketing, packaging and distribution constituting the significant methods of competition. Promotional activities include, in certain instances and where permitted by law, allowances, the distribution of incentive items, price promotions, product promotions, coupons and other discounts.

In June 2009, the President of the United States of America signed into law the Family Smoking Prevention and Tobacco Control Act ("FSPTCA"), which provides the FDA with broad authority to regulate the design, manufacture, packaging, advertising, promotion, sale and distribution of tobacco products; the authority to require disclosures of related information; and the authority to enforce the FSPTCA and related regulations. The FSPTCA went into effect in 2009 for cigarettes, cigarette tobacco and smokeless tobacco products and in August 2016 for all other tobacco products, including cigars, e-vapor products, pipe tobacco and oral tobacco-derived nicotine products ("Other Tobacco Products"). The FSPTCA imposes restrictions on the advertising,

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promotion, sale and distribution of tobacco products, including at retail. PM USA, Middleton, Nat Sherman and USSTC are subject to quarterly user fees as a result of the FSPTCA. Their respective FDA user fee amounts are determined by an allocation formula administered by the FDA that is based on the respective market shares of manufacturers and importers of each kind of tobacco product. PM USA, Nat Sherman, USSTC and other U.S. tobacco manufacturers have agreed to other marketing restrictions in the United States as part of the settlements of state health care cost recovery actions.

In the United States, under a contract growing program, PM USA purchases the majority of its burley and flue-cured leaf tobaccos directly from tobacco growers. Under the terms of this program, PM USA agrees to purchase the amount of tobacco specified in the grower contracts. PM USA also purchases a portion of its tobacco requirements through leaf merchants.

Nat Sherman purchases its tobacco requirements through leaf merchants.

USSTC purchases dark fire-cured, dark air-cured and burley leaf tobaccos from domestic tobacco growers under a contract growing program as well as from leaf merchants.

Middleton purchases burley, dark air-cured and flue-cured leaf tobaccos through leaf merchants. Middleton does not have a contract growing program.

Altria's tobacco subsidiaries believe there is an adequate supply of tobacco in the world markets to satisfy their current and anticipated production requirements. See Item 1A. Risk Factors of this Annual Report on Form 10-K ("Item 1A") and Tobacco Space - Business Environment - Price, Availability and Quality of Tobacco, Other Raw Materials and Component Parts in Item 7 for a discussion of risks associated with tobacco supply.

Wine

Ste. Michelle is a producer and supplier of premium varietal and blended table wines and of sparkling wines. Ste. Michelle is a leading producer of Washington state wines, primarily Chateau Ste. Michelle, Columbia Crest and 14 Hands, and owns wineries in or distributes wines from several other domestic and foreign wine regions. Ste. Michelle's total 2018 wine shipment volume of approximately 8.2 million cases decreased 3.3% from 2017.

Ste. Michelle holds an 85% ownership interest in Michelle-Antinori, LLC, which owns Stag's Leap Wine Cellars in Napa Valley. Ste. Michelle also owns Conn Creek in Napa Valley, Patz & Hall in Sonoma and Erath in Oregon. In addition, Ste. Michelle imports and markets Antinori, Torres and Villa Maria Estate wines and Champagne Nicolas Feuillatte in the United States.

Distribution, Competition and Raw Materials: Key elements of Ste. Michelle's strategy are expanded domestic distribution of its wines, especially in certain account categories such as restaurants, wholesale clubs, supermarkets, wine shops and mass merchandisers, and a focus on improving product mix to higher-priced, premium products. Ste. Michelle's business is subject to significant competition, including competition from many larger, well-established domestic and international companies, as well as from many smaller wine producers. Wine segment competition is primarily

based on quality, price, consumer and trade wine tastings, competitive wine judging, third-party acclaim and advertising. Substantially all of Ste. Michelle's sales occur in the United States through state-licensed distributors. Ste. Michelle also sells to domestic consumers through retail and e-commerce channels and exports wines to international distributors.

Federal, state and local governmental agencies regulate the beverage alcohol industry through various means, including licensing requirements, pricing rules, labeling and advertising restrictions, and distribution and production policies. Further regulatory restrictions or additional excise or other taxes on the manufacture and sale of alcoholic beverages may have an adverse effect on Ste. Michelle's wine business.

Ste. Michelle uses grapes harvested from its own vineyards or purchased from independent growers, as well as bulk wine purchased from other sources. Grape production can be adversely affected by weather and other forces that may limit production. At the present time, Ste. Michelle believes that there is a sufficient supply of grapes and bulk wine available in the market to satisfy its current and expected production requirements. See Item 1A for a discussion of risks associated with competition, unfavorable changes in grape supply and governmental regulations.

Financial Services Business

In 2003, PMCC ceased making new investments and began focusing exclusively on managing its portfolio of finance assets in order to maximize its operating results and cash flows from its existing lease portfolio activities and asset sales.

Other Matters

Customers: The largest customer of PM USA, USSTC, Middleton and Nat Sherman, McLane Company, Inc., accounted for approximately 27%, 26% and 25% of Altria's consolidated net revenues for the years ended December 31, 2018, 2017 and 2016, respectively. In addition, Core-Mark Holding Company, Inc. accounted for approximately 14% of Altria's consolidated net revenues for each of the years ended December 31, 2018, 2017 and 2016.

Substantially all of these net revenues were reported in the smokeable products and smokeless products segments. Sales to two distributors accounted for approximately 64% of net revenues for the wine segment for the year ended December 31, 2018. Sales to three distributors accounted for approximately 67% and 69% of net revenues for the wine segment for the years ended December 31, 2017 and 2016, respectively.

Employees: At December 31, 2018, Altria and its subsidiaries employed approximately 8,300 people. As a result of the cost reduction program announced in December 2018, there will be a reduction of approximately 900 employees, substantially all of which are expected to depart by February 28, 2019.

Executive Officers of Altria: The disclosure regarding executive officers is included in Item 10. Directors, Executive Officers and Corporate Governance - Executive Officers as of February 12, 2019 of this Annual Report on Form 10-K.

Intellectual Property: Trademarks are of material importance to Altria and its operating companies, and are protected by registration or otherwise. In addition, as of

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December 31, 2018, the portfolio of approximately 950 United States patents owned by Altria's businesses, as a whole, was material to Altria and its tobacco businesses. However, no one patent or group of related patents was material to Altria's business or its tobacco businesses as of December 31, 2018. Altria's businesses also have proprietary trade secrets, technology, know-how, processes and other intellectual property rights that are protected by appropriate confidentiality measures. Certain trade secrets are material to Altria and its tobacco and wine businesses.

Environmental Regulation: Altria and its subsidiaries (and former subsidiaries) are subject to various federal, state and local laws and regulations concerning the discharge of materials into the environment, or otherwise related to environmental protection, including, in the United States: The Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation and Liability Act (commonly known as "Superfund"), which can impose joint and several liability on each responsible party. Subsidiaries (and former subsidiaries) of Altria are involved in several matters subjecting them to potential costs of remediation and natural resource damages under Superfund or other laws and regulations. Altria's subsidiaries expect to continue to make capital and other expenditures in connection with environmental laws and regulations. As discussed in Note 2. Summary of Significant Accounting Policies to the consolidated financial statements in Item 8 ("Note 2"), Altria provides for expenses associated with environmental remediation obligations on an undiscounted basis when such amounts are probable and can be reasonably estimated. Such accruals are adjusted as new information develops or circumstances change. Other than those amounts, it is not possible to reasonably estimate the cost of any environmental remediation and compliance efforts that subsidiaries of Altria may undertake in the future. In the opinion of management, however, compliance with environmental laws and regulations, including the payment of any remediation costs or damages and the making of related expenditures, has not had, and is not expected to have, a material adverse effect on Altria's consolidated results of operations, capital expenditures, financial position or cash flows.

Available Information

Altria is required to file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission ("SEC").

Altria makes available free of charge on or through its website (www.altria.com) its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as soon as reasonably practicable after Altria electronically files such material with, or furnishes it to, the SEC. Investors can access Altria's filings with the SEC by visiting www.altria.com/secfilings.

The information on the respective websites of Altria and its subsidiaries is not, and shall not be deemed to be, a part of this report or incorporated into any other filings Altria makes with the SEC.

Item 1A. Risk Factors.

The following risk factors should be read carefully in connection with evaluating our business and the forward-looking statements contained in this Annual Report on Form 10-K. Any of the following risks could materially adversely affect our business, our results of operations, our cash flows, our financial position and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K.

We ⁽¹⁾ may from time to time make written or oral forward-looking statements, including earnings guidance and other statements contained in filings with the SEC, reports to security holders, press releases and investor webcasts. You can identify these forward-looking statements by use of words such as "strategy," "expects," "continues," "plans," "anticipates," "believes," "will," "estimates," "forecasts," "intends," "projects," "goals," "objectives," "guidance," "targets" and other words meaning. You can also identify them by the fact that they do not relate strictly to historical or current facts.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans, estimates and assumptions. Achievement of future results is subject to risks, uncertainties and assumptions that may prove to be inaccurate. Should known or unknown risks or uncertainties materialize, or should underlying estimates or assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. You should bear this in mind as you consider forward-looking statements and whether to invest in or remain invested in Altria's securities. In connection with the "safe harbor" provisions of the Private

Securities Litigation Reform Act of 1995, we are identifying important factors that, individually or in the aggregate, could cause actual results and outcomes to differ materially from those contained in, or implied by, any forward-looking statements made by us; any such statement is qualified by reference to the following cautionary statements. We elaborate on these and other risks we face throughout this Annual Report on Form 10-K particularly in the “Business Environment” sections preceding our discussion of the operating results of our subsidiaries’ businesses below in Item 7. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider the following to be a complete discussion of all potential risks or uncertainties. We do not undertake to update any forward-looking statement that we may make from time to time except as required by applicable law.

Unfavorable litigation outcomes could materially adversely affect the consolidated results of operations, cash flows or financial position of Altria or the businesses of one or more of its subsidiaries.

Legal proceedings covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions

⁽¹⁾ This section uses the terms “we,” “our” and “us” when it is not necessary to distinguish among Altria and its various operating subsidiaries or when any distinction is clear from the context.

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against Altria and its subsidiaries, including PM USA and UST and its subsidiaries, as well as their respective indemnitees. Various types of claims may be raised in these proceedings, including product liability, consumer protection, antitrust, tax, contraband-related claims, patent infringement, employment matters, claims for contribution and claims of competitors, shareholders and distributors.

Litigation is subject to uncertainty and it is possible that there could be adverse developments in pending or future cases. An unfavorable outcome or settlement of pending tobacco-related or other litigation could encourage the commencement of additional litigation. Damages claimed in some tobacco-related or other litigation are significant and, in certain cases, have ranged in the billions of dollars. The variability in pleadings in multiple jurisdictions, together with the actual experience of management in litigating claims, demonstrate that the monetary relief that may be specified in a lawsuit bears little relevance to the ultimate outcome.

In certain cases, plaintiffs claim that defendants' liability is joint and several. In such cases, Altria or its subsidiaries may face the risk that one or more co-defendants decline or otherwise fail to participate in the bonding required for an appeal or to pay their proportionate or jury-allocated share of a judgment. As a result, Altria or its subsidiaries under certain circumstances may have to pay more than their proportionate share of any bonding- or judgment-related amounts. Furthermore, in those cases where plaintiffs are successful, Altria or its subsidiaries may also be required to pay interest and attorneys' fees.

Although PM USA has historically been able to obtain required bonds or relief from bonding requirements in order to prevent plaintiffs from seeking to collect judgments while adverse verdicts have been appealed, there remains a risk that such relief may not be obtainable in all cases. This risk has been substantially reduced given that 47 states and Puerto Rico now limit the dollar amount of bonds or require no bond at all. As discussed in Note 19. Contingencies to the consolidated financial statements in Item 8 ("Note 19"), tobacco litigation plaintiffs have challenged the constitutionality of Florida's bond cap statute in several cases and plaintiffs may challenge state bond cap statutes in other jurisdictions as well. Such challenges may include the applicability of state bond caps in federal court. Although we cannot predict the outcome of such challenges, it is possible that the consolidated results of operations, cash flows or financial position of Altria, or the businesses of one or more of its subsidiaries, could be materially adversely affected in a particular fiscal quarter or fiscal year by an unfavorable outcome of one or more such challenges.

In certain litigation, Altria and its subsidiaries may face potentially significant non-monetary remedies, which may cause reputational harm. For example, in the lawsuit brought by the United States Department of Justice, discussed in detail in Note 19, the district court did not impose monetary penalties but ordered significant non-monetary remedies, including the issuance of "corrective statements."

Altria and its subsidiaries have achieved substantial success in managing litigation. Nevertheless, litigation is subject to uncertainty, and significant challenges remain.

It is possible that the consolidated results of operations, cash flows or financial position of Altria, or the businesses of one or more of its subsidiaries, could be materially adversely affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Altria and each of its subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that it has valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts. Each of the companies has defended, and will continue to defend, vigorously against litigation challenges. However, Altria and its subsidiaries may enter into settlement discussions in particular cases if they believe it is in the best interests of Altria to do so. See Item 3. Legal Proceedings of this Annual Report on Form 10-K ("Item 3"), Note 19 and Exhibits 99.1 and 99.2 to this Annual Report on Form 10-K for a discussion of pending tobacco-related litigation.

Significant federal, state and local governmental actions, including actions by the FDA, and various private sector actions may continue to have an adverse impact on us and our tobacco subsidiaries' businesses and sales volumes.

As described in Tobacco Space - Business Environment in Item 7, our cigarette subsidiaries face significant governmental and private sector actions, including efforts aimed at reducing the incidence of tobacco use and efforts seeking to hold these subsidiaries responsible for the adverse health effects associated with both smoking and

exposure to environmental tobacco smoke. These actions, combined with the diminishing social acceptance of smoking, have resulted in reduced cigarette industry volume, and we expect that these factors will continue to reduce cigarette consumption levels.

More broadly, actions by the FDA and other federal, state or local governments or agencies, including those specific actions described in Tobacco Space - Business Environment in Item 7, may impact the adult tobacco consumer acceptability of or access to tobacco products (for example, through product standards that may be proposed by the FDA for nicotine and flavors), limit adult tobacco consumer choices, delay or prevent the launch of new or modified tobacco products or products with claims of reduced risk, require the recall or other removal of tobacco products from the marketplace (for example as a result of product contamination, rulemaking that bans menthol, a determination by the FDA that one or more tobacco products do not satisfy the statutory requirements for substantial equivalence, because the FDA requires that a currently-marketed tobacco product proceed through the pre-market review process or because the FDA otherwise determines that removal is necessary for the protection of public health), restrict communications to adult tobacco consumers, restrict the ability to differentiate tobacco products, create a competitive advantage or disadvantage for certain tobacco companies, impose additional manufacturing, labeling or packing requirements, interrupt manufacturing or otherwise significantly increase the cost of doing business, or restrict or prevent the use of specified tobacco products in certain locations or the sale of tobacco products by certain retail establishments. Any one or more of these actions may have a material adverse

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impact on the business, consolidated results of operations, cash flows or financial position of Altria and its tobacco subsidiaries. See Tobacco Space - Business Environment in Item 7 for a more detailed discussion.

Tobacco products are subject to substantial taxation, which could have an adverse impact on sales of the tobacco products of Altria's tobacco subsidiaries.

Tobacco products are subject to substantial excise taxes, and significant increases in tobacco product-related taxes or fees have been proposed or enacted and are likely to continue to be proposed or enacted within the United States at the federal, state and local levels. Tax increases are expected to continue to have an adverse impact on sales of the tobacco products of our tobacco subsidiaries through lower consumption levels and the potential shift in adult consumer purchases from the premium to the non-premium or discount segments or to other low-priced or low-taxed tobacco products or to counterfeit and contraband products. Such shifts may have an adverse impact on the reported share performance of tobacco products of Altria's tobacco subsidiaries. For further discussion, see Tobacco Space - Business Environment - Excise Taxes in Item 7.

Our tobacco businesses face significant competition (including across categories) and their failure to compete effectively could have an adverse effect on the consolidated results of operations or cash flows of Altria, or the business of Altria's tobacco subsidiaries.

Each of Altria's tobacco subsidiaries operates in highly competitive tobacco categories. This competition also exists across categories as adult tobacco consumer preferences evolve. Significant methods of competition include product quality, taste, price, product innovation, marketing, packaging, distribution and promotional activities. A highly competitive environment could negatively impact the profitability, market share and shipment volume of our tobacco subsidiaries, which could have an adverse effect on the consolidated results of operations or cash flows of Altria. See Tobacco Space - Business Environment - Summary in Item 7 for additional discussion concerning evolving adult tobacco consumer preferences, including e-vapor products. Growth of the e-vapor product category and other innovative tobacco products has further contributed to reductions in cigarette consumption levels and cigarette industry sales volume and has adversely affected the growth rates of other tobacco products. Continued growth in these categories could have a material adverse impact on the business, results of operations, cash flows or financial position of PM USA and USSTC.

PM USA also faces competition from lowest priced brands sold by certain United States and foreign manufacturers that have cost advantages because they are not parties to settlements of certain tobacco litigation in the United States. These settlements, among other factors, resulted in substantial cigarette price increases. These manufacturers may fail to comply with related state escrow legislation or may avoid escrow deposit obligations on the majority of their sales by concentrating on certain states

where escrow deposits are not required or are required on fewer than all such manufacturers' cigarettes sold in such states. Additional competition has resulted from diversion into the United States market of cigarettes intended for sale outside the United States, the sale of counterfeit cigarettes by third parties, the sale of cigarettes by third parties over the Internet and by other means designed to avoid collection of applicable taxes, and imports of foreign lowest priced brands. USSTC faces significant competition in the smokeless tobacco category and has experienced consumer down-trading to lower-priced brands.

Altria and its subsidiaries may be unsuccessful in anticipating changes in adult consumer preferences, responding to changes in consumer purchase behavior or managing through difficult competitive and economic conditions, which could have an adverse effect on the consolidated results of operations and cash flows of Altria or the business of Altria's tobacco subsidiaries.

Each of our tobacco and wine subsidiaries is subject to intense competition and changes in adult consumer preferences. To be successful, they must continue to:

- promote brand equity successfully;
- anticipate and respond to new and evolving adult consumer preferences;
- develop, manufacture, market and distribute new and innovative products that appeal to adult consumers (including, where appropriate, through arrangements with, or investments in, third parties);
- improve productivity; and
- protect or enhance margins through cost savings and price increases.

See Tobacco Space - Business Environment - Summary in Item 7 and the immediately preceding risk factor for additional discussion concerning evolving adult tobacco consumer preferences, specifically the growth of e-vapor and other innovative tobacco products and the effects on our tobacco operating companies.

The willingness of adult consumers to purchase premium consumer product brands depends in part on economic conditions. In periods of economic uncertainty, adult consumers may purchase more discount brands and/or, in the case of tobacco products, consider lower-priced tobacco products, which could have a material adverse effect on the business, consolidated results of operations, cash flows or financial position of Altria and its subsidiaries. While our tobacco and wine subsidiaries work to broaden their brand portfolios to compete effectively with lower-priced products, the failure to do so could negatively impact our companies' ability to compete in these circumstances. Our financial services business (conducted through PMCC) holds investments in finance leases, principally in transportation (including aircraft), power generation, real estate and manufacturing equipment. Its lessees are subject to significant competition and uncertain economic conditions. If parties to PMCC's leases fail to manage through difficult economic and

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competitive conditions, PMCC may have to increase its allowance for losses, which would adversely affect our earnings.

Altria's tobacco subsidiaries and investees may be unsuccessful in developing and commercializin